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BEFORE THE ARIZONA CORPORATION COMMISSION

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IN THE MATTER OF THE NOTICE OF PROPOSED AMENDMENTS TO THE ARIZONA UNIVERSAL SERVICE FUND

Docket No. RT-00000H-97-0137

RUCO's Comments on ALECA Proposal

The Residential Utility Consumer Office ("RUCO") hereby provides its Comments on the Arizona Local Exchange Carriers Association's ("ALECA") proposed revisions to the Arizona Universal Service Fund ("AUSF"). RUCO regrets that it has not filed these comments by the July 1, 2005 date established by the Commission's April 13, 2005 Procedural Order, but RUCO only recently became aware of that deadline as it was not included on the service list of that Procedural Order. RUCO does wish to remain on the service list in this docket, and requests that all future matters in this docket be provided to:

Scott Wakefield
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Residential Utility Consumer Office
1110 W. Washington, Suite 220
Phoenix, Arizona 85007.

RUCO offers the following preliminary comments on the ALECA proposal:

Overview of Existing AUSF program

The current AUSF Rules were adopted in 1996. The Rules generally address two main issues: who is entitled to receive AUSF support (Rules 1202 and 1203), and from whom are funds collected to provide that support (Rules 1204 through 1215).

Who can receive support

The Rules provide that a local exchange carrier ("LEC") is eligible for AUSF support based on the difference between a cost to provide service[1] and the "benchmark rate" determined by the Commission for the individual company seeking AUSF support,[2] less any amount the LEC receives from the Federal Universal Service Fund ("FUSF").[3] Determinations for eligibility for support are made based on cost in particular geographic regions which can vary depending on the size of the LEC.[4]

The Rules classify LECs as small, intermediate or large, based on the number of access lines served in Arizona. Large LECs serve 200,000 or more access lines; intermediate LECs serve 20,00 to 199,999 lines, and small LECs serve fewer than 20,000 lines. For a large LEC, the Commission determines eligibility within US census block groups, and computes the cost to provide service based on the Total Service Long Run Incremental Cost ("TSLRIC").[5] For an intermediate LEC, the Commission determines eligibility within a support area approved by the Commission, and costs are based the TSLRIC of the incumbent provider.[6] For a small

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1 Whose cost, and the basis for that cost determination, depend on size of carrier.

2 The "benchmark rate" is the Commission-established retail rate for basic local exchange service for the LEC, plus the federal Customer Access Line Charge.

3 Rule 1202(A).

4 Rule 1202(B), (C), (D).

5 Rule 1202(D).

6 Rule 1202(C). During the first 3 years the AUSF Rules were in effect, costs for an intermediate LEC were determined based on the incumbent provider's embedded costs, and applicable geographic area was all the LEC's Arizona exchanges or other area determined by the Commission.

LEC, eligibility is determined based on a geographic area determined by the Commission, and costs are the incumbent provider's embedded costs.[7,8]

To begin receiving support, a LEC must file a rate case or follow another method the Commission may prescribe.[9] The two LECs that have received AUSF funding to date were authorized to receive that funding in the course of a rate case.[10] After a LEC begins to receive AUSF support, the Commission is to monitor the LEC's ongoing need for AUSF support every three years.[11]

<u>Who pays to provide the support</u>

The support provided to eligible LECs comes from two classes of telecommunications providers, Category 1 providers (LECs, wireless providers, paging services and other Commercial Mobile Radio Service providers)[12] and Category 2 providers (intrastate toll providers).[13] Half of the necessary support to fund eligible LECs is to be collected from Category 1 providers, and half from Category 2 providers.[14] Individual Category 1 providers are assessed their share based on the number of access lines and interconnecting trunks they have in service. Individual Category 2 providers are assessed their share based on their intrastate toll revenue. All carriers are permitted to pass their share of AUSF funding costs on to their customers.[15]

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7 Rule 1202(B). During the first 3 years the AUSF Rules were in effect, the applicable geographic area for a small LEC was all the LEC's Arizona exchanges.

8 Embedded costs are generally higher than TSLRIC. Thus, all other things being equal, a LEC would qualify for more support if its eligibility were based on embedded costs than on TSLRIC.

9 Rule 1203.

10 See Decision No. 56657 (October 10, 1989) regarding Contel of the West, nka Frontier Communications of the White Mountains, and Decision No. 64011 (September 5, 2001) regarding Midvale Telephone Exchange, Inc.

11 Rule 1216(B).

12 Rule 1204(B)(1).

13 Rule 1204(B).

14 Rule 1205(C), (D).

15 Rule 1206(A).

Summary of ALECA Proposal

ALECA proposes several modifications to the AUSF Rules that would increase the amount of AUSF funding collected from customers and provided to carriers. In addition, ALECA proposes to change the basis on which AUSF funding responsibility is allocated between customers.

Proposals impacting amount of AUSF

ALECA's first proposal to increase the amount of support obtained from the AUSF would change the basis on which eligibility for support is calculated. Currently, eligibility is calculated by comparing the costs to serve a particular geographic area to the LEC's benchmark rate. ALECA proposes to determine eligibility by comparing the LEC's costs[16] to a national average loop cost.[17] Because this proposal eliminates a review of the applicant's earnings to determine eligibility prior to receiving support, ALECA also proposes to eliminate the requirement that the Commission review a carrier's earnings every three years after it begins to receive support.[18]

ALECA's second proposal affecting the size of the AUSF is its proposed elimination of the classification of intermediate LEC.[19] ALECA proposes to expand the definition of small LEC to include all the previously-defined intermediate LECs.[20] The result of this modification

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16 ALECA's proposal maintains the current Rules' distinction in the type of "cost" that is used for this comparison. For Large LECs, it would be the TSLRIC. For Small LECs (including those currently classified as Intermediate LECs) it would be the incumbent provider's embedded cost.

17 Proposed Rule 1202.A.1. Specifically, ALECA proposes that AUSF support be calculated as the applicant's unseparated working loop cost less 115% of the national average loop cost, less any per-loop FUSF recovery.

18 Proposed Rule 1215.

19 Proposed Rules 1201(11), 1202.A.

20 Proposed Rule 1201(13).

would be to increase the number of LECs that would qualify for AUSF support based on the lower-threshold embedded cost test for small LECs.

Third, ALECA proposes to add a new provision to the Rules that would allow upward adjustment to the recoverable support for a small LEC to cover 1) any decrease in FUSF recovery resulting from a change in FUSF Rules, and 2) any increase in expenses or decrease in revenues due to a change in federal or state rules, orders, policy or law.[21] A small LEC would qualify for increased AUSF recovery for any such changes without any examination of its overall earnings by the Commission.[22]

Finally, ALECA proposes a Rule that would permit recovery of AUSF support to fund extensions of service to full-time residents in areas in which facilities are not available.[23] Support would only be permitted to fund extending service to full-time residents. Customers, or a LEC on their behalf, could request funding by filing an application, and interested parties would be permitted to request a hearing.

Allocation of support obligations to customers

ALECA's proposal eliminates the current Rules' provision that funding responsibility is allocated equally beween LECs and intrastate toll carriers. ALECA suggests that the AUSF continue to be funded by toll and local customers, but proposes that recovery be assessed equally on all intrastate retail billed revenues.

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[21] Proposed Rule 1202.A.2(a).
[22] Proposed Rule 1202.A.2(b).
[23] Proposed Rule 1202.B.

RUCO's Response to ALECA's Proposals

ALECA proposes a significant change in the basis on which support would be calculated. Currently, the Commission considers a measure of a carrier's earnings in determining whether the carrier requires AUSF funding to maintain reasonable prices. ALECA's proposal would permit AUSF funding regardless of whether a carrier actually needed subsidy, as long as the carrier's applicable measure of costs were above 115% of the national average loop cost and FUSF funding did not cover the full amount of that difference. While ALECA has not made any claim as to what it's proposal would cost, the idea that a LEC could receive a subsidy regardless of its actual need for a subsidy would be shocking if it were a novel proposal. However, the Commission rejected the idea when it adopted the current Rules, with good reason.[24] Unless a carrier can demonstrate that its costs to serve exceed its revenues, it is inappropriate to require customers statewide to fund a subsidy for that carrier. RUCO recommends that the Commission retain its current requirement that a carrier demonstrate an actual need for funding.

ALECA's proposal to eliminate the definition of intermediate carrier would permit the carriers currently considered intermediate to seek recovery based on a comparison to embedded costs rather than to TSLRIC as required under the current rules. Because embedded costs are often higher than TSLRIC costs, this change would likely result in increased recovery from AUSF. Without knowing the financial impact of this change, RUCO is unable to take a position on it at this time.

RUCO urges the Commission to reject ALECA's proposal to purchase a "pig in a poke" by pre-determining that, for small LECs, any decrease in existing FUSF revenues, or other

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[24] See Decision No. 59623 at pgs. 30-31.

increased costs or decreased revenues resulting from changes to federal or state law or regulations, would be absorbed by AUSF. By adopting such a proposal at this time, the Commission could not determine how much additional funding might be required from the AUSF. Further, adjusting AUSF recovery based on a change to a single cost or revenue element would fail to consider any other changes to costs or revenues that might have an opposite impact on a carrier's earnings. The Commission should decline to accept this invitation to engage in such single-issue rate making.

RESPECTFULLY SUBMITTED this 25th day of July, 2005.

Scott S. Wakefield
Chief Counsel

AN ORIGINAL AND THIRTEEN COPIES
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By Ernestine Gamble
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Secretary to Scott Wakefield